

# Chapter

# 9

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### **EMPLOYER RESPONSIBILITIES**

**Your responsibilities are two-fold for the active contributing member. One, you must certify that an active contributing member has ceased employment permanently before a refund will be issued. Two, you must certify the final salary, if either termination or death occurs in the current contract period.**

### **REFUND OF RETIREMENT CONTRIBUTIONS**

A member's retirement contribution is composed of the portion of the total contribution applied toward the cost of the retirement annuity plus interest earned on those monies. This amount appears in the Accumulated Contributions column on the Member's "Statement of Retirement Account." (See Chapter 14, Statement of Retirement Account).

### **EFFECT OF RECEIVING A REFUND**

Members accepting a refund forfeit their rights to KTRS benefits. Members considering a refund may want to contact us for an estimate of potential retirement and survivor benefits being forfeited by accepting the refund and for any special tax consequences that may apply. If a member leaves a KTRS-covered position and chooses not to receive a refund, the member's contributions will remain with KTRS and will eventually provide a retirement benefit if the member has at least five years of Kentucky service (See Chapter 11, Retirement Benefits). Members with fewer than five years of service credit are eligible to receive a single-sum payment at any age. Inactive member's accounts do not accumulate interest after three years of inactivity.

### **TRANSFER OF CREDIT**

KTRS cannot transfer creditable service (and the funding for that service) directly to a retirement system in another state. However, many retirement systems permit purchase of out-of-system service. We will provide the other system with verification of Kentucky teaching service if the member accepts a refund and sends us a written request. A member may then make payment for service directly to the other system, if this is required, or request a rollover of refundable contributions. (See "Refunds eligible for rollovers.")

### **REINSTATEMENT OF REFUNDED ACCOUNT**

A member may repay the refund, together with interest from the date of the refund to the date of the repayment. However, service credit that was previously forfeited by taking a refund may not be used as a basis for payment of benefits until the member completes one year of KTRS creditable service following the refunded service. Repayment of the refund is permitted under the provisions of the Kentucky Revised Statutes (KRS 161.470(3)) after the member completes at least one year of service

with a reciprocal system following the date of the refunded service credit. (See Chapter 7, Purchase of Additional Service Credit.)

The refund repayment and employment requirements must be completed before the member's retirement, death, or the commencement of disability benefits.

## **REFUNDS ELIGIBLE FOR ROLLOVERS**

Refund payments may be either made directly to the member or made in a direct rollover to an eligible retirement plan specified by the member. In a direct rollover, the eligible rollover distribution (the taxable portion) is paid directly from KTRS to a traditional individual retirement account (IRA) or another qualified retirement plan that accepts rollovers. Federal law requires that refund payments made directly to the member be subject to a mandatory 20 percent withholding. Members may avoid this mandatory withholding rule by using a direct rollover method of distribution. In addition, if the member chooses a direct rollover, the distribution is not taxed until it is withdrawn from the IRA or other qualified retirement plan.

## **TAXABILITY OF REFUNDS**

That portion of a member's refund that is attributable to contributions made after January 1, 1998, is subject to the Kentucky Individual Income Tax. The 1099R issued by KTRS will provide the amount to be used in calculating the member's Kentucky Tax Liability. However, any portion of the refund attributable to contributions made by either the member or employer that were excluded from the member's taxable income in the years the contributions were made is subject to federal income tax.

To aid our members, correct and complete applications received before the close of business on June 1 will be processed in the current fiscal year. Refund applications received after June 1 will be processed in the next fiscal year. Since interest is posted to members' accounts on July 1st, members refunding after June 1 will receive a larger refund.

Refund recipients will be notified of the taxable portion of their refunds. We also will report the refund payment to the Internal Revenue Service and the Kentucky Revenue Cabinet on IRS Form 1099-R and will send the refund recipient a copy of this form in January in the year after the refund is taken. Special tax consequences and penalties may apply to refund payments. Members should consult a professional tax consultant for details of the taxability of refunds.

Additional information is also contained in Internal Revenue Service Publication 575, Pension and Annuity Income. To obtain this publication, visit the IRS Web site, [www.irs.gov](http://www.irs.gov) or call (800) 829-3676 and the Kentucky Revenue Cabinet's Web site at [www.revenue.state.ky.us](http://www.revenue.state.ky.us).

KTRS refunds are generally made under two circumstances:

- (1) A member terminates employment; or
- (2) the member (active or retired) dies.

## **ELIGIBILITY REQUIREMENTS FOR A REFUND UPON EMPLOYMENT TERMINATION OF MEMBER**

**(KRS 161.470)** Members may receive a refund if they terminate employment with a KTRS employer. 102 KAR 1:060 requires that a member not be under a contract for employment in a KTRS-covered position. The member and the employer must certify that the member's termination of employment is permanent.

A member who is on sick leave, a sabbatical, or an unpaid leave of absence is not considered to have terminated service and, therefore, is not eligible for a refund. A member transferring from one KTRS employer to another is also not eligible for a refund. A member under a contract or plan to be employed in a KTRS position the following year is not eligible to apply for a refund at the close of the school year.

If the member is eligible for an immediate retirement allowance provided by KRS 161.600, then a refund will not be permitted unless the member's KTRS annuity would make the member ineligible for Social Security benefits. Members who are eligible for retirement may refund, under certain conditions, all/part of their KTRS service to obtain service credit in another retirement plan.

This refund consists of the member's retirement contributions plus interest earned on those monies. The contribution to the Teachers' Medical Insurance Fund (MIF) is not refundable.

### **EMPLOYER RESPONSIBILITIES**

**Employers must complete Part B of the Refund Application (Form 11). The refund application should not be completed until the employer has paid the KTRS member their final compensation. It is very important that the employer accurately complete this section since the employee's refund will be based on this information. If the employee is overpaid because of incorrect employer data, then the employer is responsible for the amounts incorrectly paid to the employee.**

### **APPLICATION PROCEDURE**

To obtain a refund, a member must file a Refund Application (Form 11) with us. The application is available through our KTRS Information Center, (502) 848-8660, or our Member Services Division, (800) 618-1687. Completed applications must be returned to our office. We will process the refund and forward it to the Kentucky State Treasurer for payment.

Properly completed applications are processed twice each month. Average processing time is two to four weeks. Refund checks are mailed around the 15th and 30th of each month.

## **ELIGIBILITY REQUIREMENTS FOR A REFUND UPON MEMBER DEATH**

**(KRS 161.520 - 161.525)** Under certain conditions, the member's beneficiary or estate may receive a refund of the member's account balance upon the member's death (See Chapter 13, Benefits Payable upon Death). When this occurs, there are options available to the surviving spouse that are not available to a non-spouse beneficiary.

### **SURVIVING SPOUSE**

A beneficiary who is a surviving spouse of a deceased member may (1) elect to roll over the taxable portion of a lump-sum payment and thereby defer taxation until the amount rolled over is later received or (2) elect to receive a single-sum refund. A surviving spouse can either request that KTRS make a direct rollover or elect to receive the payment and then roll it over within 60 days. However, if a direct rollover is not requested, a mandatory 20 percent of the taxable portion of the payment must be withheld.

### **DIRECT ROLLOVERS BY A SURVIVING SPOUSE**

Surviving spouses who are entitled to receive a payment eligible for rollover may elect a direct rollover. In a direct rollover, KTRS pays the taxable portion of the payment directly to an eligible plan, account, or annuity on the behalf of the surviving spouse. The amount rolled over is not subject to income tax until it is distributed from the eligible plan, account, or annuity. A surviving spouse who wants a direct rollover should contact an eligible plan, account, or annuity sponsor (usually a financial institution) to determine whether it will accept a direct rollover and if so, how to have the payment paid in a direct rollover to the plan at that institution. A surviving spouse who is unsure of how to invest the money can temporarily establish an IRA to receive the payment. However, in choosing an IRA, consideration should be given to whether the traditional IRA will allow a transfer of all or part of the money to another eligible plan, account, or annuity at a later date without penalties or other limitations. See IRS Publication 590, Individual Retirement Arrangements, for more information regarding IRAs. Before a direct rollover is made, both the surviving spouse and the financial institution that is to receive the rollover must certify to KTRS that the financial institution is eligible to and will receive the direct rollover.

**Please note: The nontaxable portion of a member's account cannot be rolled over. For this reason, the nontaxable amount will automatically be paid directly to the surviving spouse.**

#### **Other considerations**

If a direct rollover is not elected, the amount that could have been directly rolled over will be subject to mandatory 20 percent federal income tax withholding requirements.

If the taxable portion of the payment is less than \$200, it is not eligible for a direct rollover and is not subject to 20 percent federal income tax withholding.

If the taxable portion of the payment is more than \$500, the surviving spouse may elect to receive part of the payment and have the balance directly rolled over into an eligible plan, account, or annuity; however, the direct rollover must be at least \$500.

If the taxable portion of the payment is less than \$500 and greater than \$200, the surviving spouse must either receive 100 percent or have 100 percent of the taxable portion directly rolled over.

The portion, if any, of a payment that is a "required minimum payment" under federal law cannot be rolled over.

### **DIRECT ROLLOVER COMPARED TO SINGLE-SUM PAYMENT**

If a surviving spouse receives a payment in lieu of a direct rollover to a traditional IRA, the surviving spouse may still roll over all or part of the taxable portion of the payment including the amount withheld if the surviving spouse has other funds available to make up the difference. However, the rollover must occur within 60 days of receipt of the payment.

For example, assume the surviving spouse is eligible to receive a taxable distribution of \$10,000 and elects to receive the entire amount. The surviving spouse will actually receive only \$8,000 because \$2,000 (20 percent) is withheld for federal income tax. Within 60 days after receiving the payment, the surviving spouse may elect to roll over the entire \$10,000 to an IRA. To make the rollover, the surviving spouse must find \$2,000 from other sources (e.g., savings, loan). In this case, the \$10,000 is not taxed until withdrawn from the IRA. However, if the surviving spouse rolls over only \$8,000, the \$2,000 is taxed in the year it was withheld.

If the surviving spouse elects to receive a single-sum payment, the taxable amount received is subject to mandatory 20 percent federal income tax withholding. For example, if the surviving spouse is entitled to a taxable payment of \$10,000, only \$8,000 is paid because KTRS must withhold \$2,000 for federal income tax. However, when the surviving spouse prepares his or her tax return, the full \$10,000 is reported as the taxable payment. The \$2,000 is reported as tax withheld and will be credited against any income tax owed for that year.

### **APPLICATION PROCEDURE**

A surviving spouse must file a Refund Application (Form 12AA or 12AR) and the optional rollover paperwork with us. The application and rollover designation is available through our KTRS Information Center, (502) 848-8660, or our Member Services Division, (800) 618-1687. Completed paperwork must be returned to our office. Once all completed paperwork is received, we will process the payments and forward the requests to the Kentucky State Treasurer for payment.

Properly completed applications are processed twice each month. Average processing time is two to four weeks. Checks are mailed around the 15th and 30th of each month.

## **NON-SPOUSE BENEFICIARY**

Direct rollovers are not available to non-spouse beneficiaries. Lump-sum payments to a non-spouse beneficiary of a deceased member are not subject to mandatory 20 percent withholding for federal income tax. Withholding tax on a distribution to a non-spouse beneficiary is voluntary. We highly recommend that the recipient withhold at least 10 percent.

## **APPLICATION PROCEDURE**

The non-spouse beneficiary must file a Refund Application (Form 12A or 12R) with us. The application is available through our KTRS Information Center, (502) 848-8660, or our Member Services Division, (800) 618-1687. Completed applications must be returned to our office. We will process the refund and forward it to the Kentucky State Treasurer for payment.

Properly completed applications are processed twice each month. Average processing time is two to four weeks. Checks are mailed around the 15th and 30th of each month.

## **SPECIAL REFUNDS**

Occasionally refunds are processed to correct errors of incorrect submission of monies to KTRS. Some of the reasons for these refunds are:

1. Refund because the member's payment exceeded the amount necessary;
2. Refund because employer incorrectly reported contributions on the original refund application form;
3. Refund because the member is ineligible for membership in KTRS;
4. Refunds because the member wishes to transfer partial credit to another state; and
5. Refund of excess member contributions - Final salary exceeded average salaries of other teachers in the district.

KTRS must receive a written explanation and documentation of the monies remitted in error. Upon review by KTRS, a "Special Refund Authorization" is prepared and processed. Special refunds are payable to the employer who is responsible for correcting tax forms for the individual.